STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 97-886

February 18, 1998

PUBLIC UTILITIES COMMISSION,
Requirements for Non-Core
Utility Activities and Transactions
Between Affiliates (Chapter 820)

ORDER PROVISIONALLY
ADOPTING RULE AND
STATEMENT OF FACTUAL
AND POLICY BASIS

WELCH, Chairman; NUGENT and HUNT, Commissioners

I. INTRODUCTION

In this Order, we provisionally adopt a rule creating Chapter 820 of our rules, Requirements for Non-Core Utility Activities and Transactions between Affiliates. The rule incorporates the principles established in *Robert D. Cochrane v. Bangor Hydro-Electric Company, Request for Commission Investigation into Bangor Hydro-Electric Company's Practice of Installing or Monitoring Security Alarm Systems,* Docket No. 96-053 (January 28, 1997).

In that case, we determined that Bangor Hydro-Electric Company (BHE) could operate its security alarm business (CareTaker) subject to certain conditions. These conditions included: below-the-line accounting for the non-core activity; a requirement that the non-core activity take place in a separate corporate entity; and limits on the use of customer information. In the *Cochrane* Order, we stated that we expected to apply the general principles articulated in *Cochrane* to all utilities, but that we would do so through a generic rulemaking.

II. STATUTORY REQUIREMENTS

In May 1997, the Legislature enacted L.D. 502, "An Act to Require Fair Compensation for Ratepayer Assets Used by a Subsidiary or Affiliate of a Utility." This Act is codified in sections 707, 713, 714 and 715 of Title 35-A. The provisions of the Act require that if an affiliated interest of a utility expects to use a facility, service or intangible, including the good will or company name, the affiliate must pay the utility for the value of the use of the facility, service or intangible. 35-A M.R.S.A. § 707(3)(G). The Commission must determine the proper allocation of costs for shared facilities, services or intangibles. *Id*. The statute further provides that a utility may not charge its ratepayers for costs attributable to unregulated business ventures undertaken by the utility or an affiliated interest, 35-A M.R.S.A. § 713; requires that the utility provide notice to the Commission of any business activity not regulated by the Commission, 35-A M.R.S.A.§ 714; and directs the Commission to adopt rules that prescribe the allocation of costs for facilities, services or intangibles that are shared between regulated and unregulated activities of a utility or an affiliated interest, 35-A M.R.S.A. § 715.[1] The provisionally adopted rule is in accordance with these statutory requirements.

III. NOTICE OF INQUIRY AND RULEMAKING PROCESS

On April 2, 1997, the Commission issued a notice of inquiry into the requirements for utilities conducting non-core utility activities. *Public Utilities Commission, Inquiry into Requirements of Conduct and Structure for Utility Involvement in Non-Core Activities,* Docket No. 97-173 (April 2, 1997). The Notice of Inquiry asked utilities and other interested persons to comment on a series of questions about the applicability of the Cochrane principles to all utilities.

On December 4, 1997, we issued a Notice of Rulemaking and proposed rule regarding requirements for non-core utility activities and transactions between affiliates. Consistent with rulemaking procedures, the Commission provided interested persons an opportunity to file written comments on the proposed rule. The following persons provided written comments on the proposed rule: Central Maine Power Company (CMP); Bangor Hydro-Electric Company (BHE), Maine Public Service Company (MPS), Electric Edison Institute (EEI), Dirigo Electric Cooperative (Dirigo), Telephone Association of Maine (TAM), Bell Atlantic-Maine (BA-ME), AT&T Communications of New England (AT&T), Maine Water Utilities Association (MWUA), Maine Rural Water Association (MRWA), Kennebec Water District (KWD), Portland Water District (PWD), Consumers Maine Water Company (Consumers Maine) and the Public Advocate (OPA).

In addition, the Commission held a rulemaking hearing to allow interested persons to provide oral comments and to respond to questions regarding their position. The following persons participated in the hearing: CMP, BHE, MRWA, MWUA, Dirigo, and Consumers Maine.

The Commission appreciates the efforts of interested persons in providing comments on the issues relating to non-core activities and transactions between affiliates. The Commission found the comments helpful in developing the provisional rule.

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[1]Because the rule we are required to adopt is a "major substantive rule" as defined and governed by 5 M.R.S.A. §§ 8071-8074, the Legislature must review the provisional rule and authorize its final adoption either by approving it with or without change or by taking no action. 5 M.R.S.A. § 8072.

IV. DISCUSSION OF PROVISIONAL RULE AND COMMENTS

A. Section 1. Exemptions

The proposed rule applied to all electric, water, telephone and gas utilities. The provisional rule exempts all consumer-owned utilities, as defined in 35-A M.R.S.A. §§ 3501 and 6101, and exempts all water and telephone utilities from all provisions of the rule except for subsections 4(C), 4(D), 6(B) and 6(C) relating to valuation of intangibles and ratemaking treatment for use of intangibles. The definition section of the rule further limits the application of the rule by excluding from the definition of non-core services *de minimus* and mutual aid services. These limitations will be discussed in section 2 below.

1. Exemption of Consumer-Owned Water Utilities

In its comments, Dirigo suggested that this rule should either not apply to consumer-owned utilities (COUs) or its application should be limited. MWUA noted that it might be difficult to apply the proposed rule to COUs:

> Given the definition of affiliated interest, as stated in section 707, we question how this proposed rule can apply to consumer owned water utilities. Do consumer owned water utilities even have voting securities?
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> . . . .
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> How would a consumer owned water utility go about establishing such a subsidiary? Would it also be quasi-municipal entity? Are there standards or procedures to follow in establishing such a subsidiary?

These questions, and the likely answers (if any) to them, provide a reasonable basis to exclude COUs from the applicability of Chapter 820. Further, because COUs are owned by the utility ratepayers, there is no incentive for such utilities to inappropriately shift costs from the non-core activity to the utility ratepayers. Moreover, the activities of COUs are limited by the purposes set out in their legislative charters and by the provisions of 35-A M.R.S.A. § 3503(5) (for consumer-owned electric utilities) and Section 6105(4) (for consumer-owned water utilities).

2. Partial Exemption of Telephone Utilities

Section 2 of the proposed rule described which local exchange carrier (LEC) services would be defined as core services and which would be considered non-core. Because the proposed rule contained a requirement that all non-core activities be conducted through a separate affiliate, TAM and BA-ME suggest that LECs should either be exempt from the rule, or that separate provisions should be adopted for them. The provisional rule exempts telephone utilities from the rule except for sections 4(C) and 4(D) relating to valuation of utility intangibles and Section 6(B) and 6(C) relating to ratemaking treatment of intangibles.

TAM commented that the rule is not necessary for LECs because the activities between those utilities and their affiliates, as well as the apportionment of costs between regulated and non-regulated activities conducted within the same corporate entity, are already extensively regulated by the Federal Communications Act of 1934, as amended by the Telecommunications Act of 1996 (TelAct 96), by the accounting, affiliate transactions and separations rules of the Federal Communications Commission (FCC), and by rules and practices of the MPUC. Further, TAM asserted that the increasingly competitive environment that exists in the telecommunications industry makes the rule unnecessary for LECs.

TAM pointed out that parts of the proposed rule seem to run counter to the move to relax or remove regulatory oversight from local and long-distance competitors. TAM also asserted that if the proposed rule were made applicable only to incumbent LECs (ILECs), it would serve to increase the regulatory inequity between the ILECs and the competitors. TAM stated that if LECs are to be subject to the rule at all, they should be considered separately from other utilities, because the telecommunications industry is much further along the road to becoming fully competitive than any of the other industries. TAM further asserted that federal laws and regulations and the Commission's rules and practices provide sufficient safeguards and oversight to prevent cross-subsidies and unfair competitive practices that might otherwise result. Finally, TAM pointed out that several utilities already have holding company organizational structures that have been examined and approved by the Commission. According to TAM, numerous management services agreements and support services agreements already govern the transactions and arrangements between LECs and their affiliates.

BA-ME stated that many portions of the proposed rule conflict with the federal statutory and regulatory schemes and, therefore, are likely to be preempted. BA-ME asserted that the federal mechanisms fully insulate its regulated ratepayers from the risks associated with the business endeavors of its affiliates. Further, the Alternate Form of Regulation (AFOR) under which BA-ME currently operates in Maine removes, or at least significantly reduces, the incentive the utility may have had to cross-subsidize its regulated operations.

Specifically, BA-ME suggested that the structural separations requirements of the proposed rule should not be applied to LECs, because TelAct 96 prescribes the lines of business that must be entered through a separate subsidiary. See 47 U.S.C. § 272. Under federal law, all other permitted activities may be conducted as part of the utility's operations but are subject to the accounting, affiliate interest and separations rules prescribed by the FCC. BA-ME asserted that by requiring additional structural separations for non-core activities, the Commission would impose additional costs on the utilities, and these costs would be passed on proportionately to Maine ratepayers and to consumers of the non-core services.

AT&T commented that the proposed rule's definition of core services is inconsistent with FCC rulings and should be modified. AT&T further pointed out that the FCC has made slight modifications to its affiliate transactions rules, but that the FCC affirmed that a prevailing price methodology should be used when available.

We conclude that, except for the provisions contained in subsections 4(C) and 4(D) of the provisional rule regarding the valuing of intangible assets and the related subsections on ratemaking treatment contained in subsections 6(B) and 6(C), incumbent local exchange carriers in Maine should be exempt from the provisions of Chapter 820. We agree that the competitive environment of the telecommunications industry, combined with the provisions of TelAct 96 and the accounting, affiliate transaction and separations rules propounded by the FCC, are sufficient to prevent the kind of cross subsidization and cost-shifting addressed in the proposed rule. All LECs in Maine are subject to the principles of the federal rules, as we have adopted the FCC's accounting rules as our own, and any of the independent telephone utilities that have come before us recently for approvals of affiliate interest creations, or approvals of transactions with their affiliates, have been subject to the cost allocation principles contained in the federal scheme.

We believe the rules and regulations already in place are adequate. We will not require LECs to adhere to separate affiliate provisions. We retain our authority to impose conditions on the creation of affiliates and on any transactions between affiliates, should that be necessary. *See* 35-A M.R.S.A. §§ 707, 708.

We require LECs to adhere to the intangible asset valuation rules contained in section 4 and ratemaking provisions of subsections 6(B) and 6(C) on a prospective basis. Any new affiliates formed that make use of any of the LECs' intangible assets must follow the valuation and ratemaking provisions set forth in these sections. In addition, any new affiliated transaction between existing affiliates will be subject to these sections of the rule. The utility may seek a waiver from these provisions, but the burden of justifying such a request remains with the utility.

3. Partial Exemption of Investor-Owned Water Utilities

The MRWA suggested we exempt water utilities entirely:

> Our first preference is to exclude water utilities from this rulemaking altogether. If this is not possible, our second preference is to expand the definition of core activities to include [mutual aid and support services provided to other water utilities] even if these services are provided outside of a utility's service area. Our third preference is to establish some sort of fiscal cap, so that utilities with revenue below a certain dollar figure from "non-core activities" would be waived from this rule.

MRWA further claimed that the proposed rule's requirement to establish separate corporate entities and the imposition of FCC cost accounting rules would dramatically reduce shared services and support among water systems in Maine. It noted that water systems have a long history of mutual aid and support such as the provision of supplies, equipment, manpower, technical expertise sale of water, laboratory service, billings, operators and management. It further argued that requirements that reduce mutual aid and support would be contrary to "one of the keystones of the Reauthorized Safe Drinking Water Act [which is] to promote water system linkages and reorganization where necessary."

Consumers Maine expressed concerns similar to those of the MRWA. Consumers Maine was particularly concerned that the proposed rule's definition of core service, by excluding services provided outside a utility's service territory, would discourage the sharing of expertise among water utilities. Consumers Maine noted that water systems help one another outside of their territories by providing: assistance in operations, management, emergency response, billing, customer service meter reading, and laboratory services.

Consumers Maine, like MRWA, further noted that the Safe Drinking Water Act "encourages the consolidation of small systems due to problems with non-viable systems," and suggested that the requirement of a separate entity could eliminate the mutual aid activities of water systems or increase the cost to water customers of providing those services. Consumers Maine also stated that "[n]o water utility in Maine comes close to the size and sophistication of the electric, gas, or telecommunication companies in Maine." In addition, Consumers Maine stated that accounting requirements for water utilities already protect against cross-subsidization when a utility provides services outside of its service territory. Requiring a separate entity, in Consumers Maine's view, will add administrative costs without providing any benefit. Finally, Consumers Maine suggested that an alternative to changing the definition of non-core activities is to allow a blanket waiver for water utilities or a waiver if the services being provided are below a *de minimus* threshold. Consumer's Maine provided additional information indicating that the annual revenues from each individual non-core service it provides to other utilities are below $100,000.

MWUA requested that consumer-owned water utilities be completely exempted from the requirements of Chapter 820 and that investor-owned water utilities be exempted for those activities and services which they perform for other utilities. It noted that current accounting requirements already require separate accounting for non-core activities. It also expressed a concern that the rule would hamper the provision of mutual aid among water utilities.

We agree that the nature and scale of non-core activities provided by investor-owned water utilities do not warrant the regulatory and transaction costs of requiring such utilities to comply with Chapter 820. The degree of diversification into competitive non-core ventures that is apparent in electric, gas and telecommunications utilities is simply not present in water utilities. Moreover, we agree that the rule should not have the effect of limiting cost-effective mutual aid among Maine's utilities. While many activities of Maine's investor-owned water utilities would likely be exempted from most of the provisions of the rule because the activities would not be included in the definition of non-core services (*see* section 2 below), we have chosen instead to apply a blanket exclusion from the requirements of the rule except for sections 4(C) and 4(D) (valuation of intangibles) and 6(B) and 6(C) (ratemaking treatment for payment for use of intangibles) in any affiliated transaction. This section would apply only if the use of intangibles were part of any affiliated transaction pursuant to section 707(3)(G). Based on the comments provided, we note that such affiliated transactions are unlikely to occur because water utilities generally have not created affiliates. However, if such transactions do occur we do not believe it is consistent with the intent of L.D. 502 or with the interests of ratepayers to exempt such transactions from these provisions. See 707(3)(G). We will continue to examine specific affiliated transactions as required by 35-A M.R.S.A. § 707. If, in the future, we determine that circumstances warrant requiring investor-owned utilities to be subject to the provisions of Chapter 820, we may open a rulemaking proceeding to amend the rule.

B. Section 2: Definitions

Several of the definitions in the proposed rule derive from the *Cochrane* case. For example, the definitions of Aggregate Customer Information (ACI) and Customer Specific Information (CSI) essentially mirror the definitions supplied in the *Cochrane* Order. We discuss below the definitions on which we received comments.

1. Core services; Non-core services

The proposed rule defined core utility service as:

> "Core utility service" means the generation, transmission or distribution of electricity, gas or water and activities necessary to perform those functions, except that any service that a utility provides outside of its service territory, is not a core service. Services necessary to perform generation, transmission or distribution functions include billing and meter reading. For telephone local exchange carriers, core utility service means any services provided by the LEC as part of the public switched network, as well as private lines, except that information services, interlata toll services and manufacturing operations, and services provided outside of the LEC's service territory are not core services.

The proposed rule included the following definition for Non-Core Utility Service:

> "Non-core utility service" is any service provided by an electric, gas, water utility, or telephone local exchange carrier, or any affiliate of these entities, that does not meet the definition of core utility service or incidental service.

The provisional rule defines core service as:

> "Core utility service" means the generation, transmission or distribution of electricity or gas, services necessary to perform those functions, services for which the utility is the provider of last resort or services the Commission requires the utility to provide, except that any service that a utility provides outside its service territory, is not a core service.

The provisional rule defines non-core service as:

> "Non-core service" is any service provided by an electric or gas utility, or any affiliate of an electric or gas utility, that does not meet the definition of core utility service, *de minimus* service or mutual aid service.

The Public Advocate, BHE, CMP, MPS, AT&T, BA-ME, and Consumers Maine commented on the definitions of utility core and non-core utility activities. CMP, MPS, BHE and the Public Advocate suggested modifying the definition of core services in a way that more clearly includes certain services that have traditionally been provided by the utility (e.g. DSM, relay protection), but that might have been considered non-core under the proposed rule's definition.

CMP suggested specific language for the definition of core services: "'Core utility service' means . . . any work done on the utility side of the delivery point, including billing and meter reading. Any work done on the customer side of the delivery point is a non-core utility service."

BHE suggested the Commission should adopt the following definitions:

> "Core" products and services are those that are provided by a public utility under rates, terms, and conditions that are established in a utility's tariffs or other documentary filings that are subject to approval by the Public Utilities Commission (such as contracts for regulated service) or that are otherwise subject to regulation by the Commission (such as billing, dispute resolution, meter reading, and related services).
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> "Non-core" services are all services that are not “core" services or "incidental" services.

BHE also questioned the proposed rule's exclusion of services provided outside a utility's service territory. BHE stated:

> If the intent is to prevent Bangor Hydro from providing, for example, billing and metering services outside its service territory without creating an affiliate, then it seems to us that core utility customers may be paying a higher then [sic] necessary cost because a potential competitive party will be eliminated from the market.

MPS commented:

> If energy audits or relay protection are available in the competitive market, no valid purpose is served by prohibiting the utility from offering this service on a competitive basis, even in its own service territory, by insisting they be "core" functions.

BA-ME and AT&T commented on the definition of core services with respect to the telephone industry.

As discussed above, water utilities and telephone utilities are exempted from all provisions of this rule except subsections 4(C), 4(D), 6(B) and 6(C). Therefore, we have removed the reference to water utilities and LECs from the definition of core and non-core utility services.

We agree with CMP, MPS, BHE and the Public Advocate that the definition of core services should more clearly include certain services for which the utility is the traditional provider. The provisional rule includes in the definition of core services those services for which the utility is the provider of last resort as well as those services the Commission requires the utility to provide.

We did not adopt CMP's proposed definition of core services for two reasons: 1) we do not have sufficient information available to be certain that all services provided on the utility side of the delivery point should necessarily be considered core and conversely that all services provided on the customer side of the delivery point should be non-core and 2) a definition should be flexible and able to change as the industry evolves. It is not clear that CMP's definition would allow that flexibility. The definition we adopt provides flexibility. To the extent the utility is no longer the provider of last resort or is no longer required to provide the service, the service is non-core.

The provisional rule's definition of core services is similar to that suggested by BHE. However, we decline to adopt BHE’s proposal to exclude, from the definition of core services, services provided outside the utility's service territory. The intent of the rule is to protect a utility's core ratepayers from risk associated with the utility's non-core ventures and to provide a framework for the appropriate cost allocations to be used for core and non-core ventures.

We do not agree with MPS that the provisional rule's definition of core and non-core activities will result in eliminating any competitor from any market. We do not expect that the burdens imposed on a utility's affiliate outside the utility's territory will place that affiliate at a disadvantage relative to its competitors. In any case, a “core” service provided outside a utility’s service territory is much more closely related, with respect to the benefits and burdens that might flow to the utility’s ratepayers, to other activities (including non-core services) not directly performed for the benefit of those ratepayers. These requirements of the rule do not prevent a utility from offering any service to anyone; they merely ensure that to the extent a utility offers service outside the area where it is serving its core customers, those customers are adequately insulated from losses.

2. Mutual Aid Services

The proposed rule did not exempt mutual aid services from the definition of non-core services. Consumers Maine and MRWA suggested that there should be an exemption for mutual aid services, referring to services that one water company might perform for another water company on a regular basis as mutual aid. Given the recent utility experiences related to the ice storm of 1998, we agree and conclude that a mutual aid exemption should exist for all utilities subject to this rule.

The provisional rule defines mutual aid service as:

> Service that meets the definition of core services when provided within a utility's own service territory but that is provided temporarily outside the utility's service territory for the sole purpose of assisting another utility in meeting its service obligations.

Although such an exemption was not included in our proposed rule and was not discussed by commenters other than water utilities, we believe it is consistent with the intent of the proposed rule. The intent was to provide appropriate safeguards and parameters for utilities that pursue non-core activities, not to make more cumbersome those activities in which utilities assist one another in the normal course of business or in emergency situations. To provide more clarity, we have now included a specific exemption from the requirements of this rule for services provided as mutual aid. Mutual aid services are excluded from the definition of non-core services and are not subject to the requirements of the rule.

3. *De minimus* services

The proposed rule defined incidental services as any non-core utility service provided on an occasional basis to either utility customers or non-customers that is not marketed, or is designed to have a negligible revenue impact.

In the provisional rule we have substituted, for the definition of incidental service, the following definition of *de minimus* service:

> "*De minimus* service" is service for which the investment does not exceed 0.1% of the utility's capitalization and total gross revenues received from providing that service do not exceed 0.1% of the utility's annual gross revenues. If the total revenues received from providing all *de minimus* services exceeds 2% of the utility's gross annual revenues or if the utility's total investment for all *de minimus* services exceeds 2% of the utility's capitalization, the utility shall report that fact and the associated details to the Commission, which may, at its discretion, investigate and dispose of the matter as appropriate, including a determination that one or more of the services is no longer *de minimus*. If the utility continues a service thus determined not to be *de minimus*, it must be established as a non-core service consistent with the appropriate sections of this rule. Notwithstanding the preceding sentence, the utility may, at any time, provide *de minimus* services up to the above stated individual and aggregate limits.

These services are excluded from the definition of non-core services and thus are not subject to the requirements of the rule, except for the requirement that *de minimus* service will be treated as below the line for ratemaking purposes (subsection 6(A)) and the requirement that a utility account for the *de minimus* service’s use of utility resources in the same manner required for affiliates’ use of the utility’s resources. Subsection 4(A).

Consumers Maine, Dirigo, MRWA, MWUA, BHE, MPS and the Public Advocate commented on either the incidental activity exemption in the proposed rule or a *de minimus* exemption. All agreed that an exemption was appropriate for activities that have limited revenue impact.

Consumers Maine and MRWA supported a provision that exempts activities of less than $200,000 per year from the requirements of the rules. Dirigo suggested that activities with less than a 2% revenue impact be exempted. MWUA was unsatisfied with the proposed rule's definition of incidental services as those services provided on an "occasional basis."

BHE suggested the following definition of incidental services:

> "Incidental" products and services are those that are provided by a public utility to its employees, investors, and members of their immediate families that are not available to the general public and that do not collectively result in revenues of more than 0.1% of the utility's gross annual revenues.

The Public Advocate supported the definition in the proposed rule but suggested including "to the general public," resulting in the following definition:

> "Incidental service" is any non-core utility service provided on an occasional basis to either utility customers or non-customers that is not marketed *to the general public* or is designed to have a negligible revenue impact.

MPS suggested that the definition of incidental service be amended "to include any 'core' service offered on an occasional basis and which has a negligible impact on revenues." MPS contended that "[u]nder this expanded definition, it would not matter if the ‘incidental’ services were 'core' or 'non-core' if they remained a *de minimus* aspect of the utility's operations" and that "if the utility wished to transfer a 'core' 'incidental' function to an unregulated affiliate it would require the Commission's authority under 35-A M.R.S.A. §707."

We have incorporated BHE’s suggestion of establishing a ceiling amount of 0.1% of the utility’s annual gross revenues for an individual *de minimus* activity. The provisional rule also limits the amount of investment that could be made in a de minimus activity.[2] These combined limits provide

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[2]In our proposed rule, we included an exemption for incidental services. Commentors seemed to refer to this type of an exemption as a *de minimus* exemption. Because this was the term apparently preferred by commentors and is more descriptive

additional assurance that services excluded from the rule are *de minimus* both in revenues generated and the size of the utility's investment. In addition, the provisional rule establishes an aggregate annual ceiling for *de minimus* ventures of 2% of the utility's annual gross revenues and 2% of the utility's capitalization. The aggregate limits prevent a utility from allocating a substantial portion of its resources to non-core ventures without specific Commission approval.

We do not adopt the change suggested by the Public Advocate. The provisional definition is more specific because it defines what constitutes a negligible revenue impact. No higher limit is needed to accommodate mutual aid situations because, as described above, we have exempted mutual aid from the reach of the rule. Because it is more specific in its revenue impact limitations and does not include activities that have more than a negligible revenue impact, the provisional rule's definition is preferable to the definition included in the proposed rule and modified by the Public Advocate.

We believe the definition of *de minimus* services in the provisional rule addresses MPS's concerns. Thus, we do not adopt MPS's proposed changes.

4. Good Will and Intangibles

The proposed rule also contained definitions of good will and intangibles; these terms are included in L.D. 502. No comments were received on the definition of intangibles and this definition has not been modified in the provisional rule. The provisional rule contains a modified definition of good will. The provisional rule defines good will as:

> Good will" is a benefit or advantage to the utility of having an established reputation and established customer relationships, and includes the use of the name and reputation of the utility. The use of the good will of the utility by an affiliate is conclusively established where 1) the affiliate uses the name of the utility; or 2) the affiliate engages in joint marketing or joint advertising with the utility.

The Public Advocate supported the proposed rule's definition of good will. He stated that the proposed rule's definition of good will

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of the types of activities we are exempting under this provision, we have chosen to define this exemption now as *de minimus* rather than incidental.

> is sufficiently broad to allow the Commission to assess the true value that an affiliate may reap from its association with the utility and to ensure that ratepayers retain the value of that benefit. This definition is also appropriate in order to ensure a fair competitive playing field.

BHE objected to the proposed rule's definition of good will. It asserted that the definition is overly broad and ambiguous. BHE instead suggested we adopt the accounting definition and define good will as "the excess of market price over book value when a business is purchased or acquired by another business."

We decline to adopt BHE's suggested definition of good will. We do not believe that, in enacting L.D. 502, the Legislature intended that we use the formal accounting meaning of "good will." In our view, the Legislature intended that where value has been created by the utility's opportunity to provide service to ratepayers within a virtually although not always entirely exclusive franchise territory, that value should flow back to ratepayers. If a utility's competitive, non-core business is to provide returns to shareholders, those returns should flow from the skill, foresight and industry of the new venture, and not on the association with the utility. Moreover, using the accounting definition proposed by BHE might yield a negative value for good will, a result we doubt the Legislature intended (though, of course, the value could be zero). The provisional rule's definition is consistent with the way the term has been used in other jurisdictions in which the issue of payment for an affiliate's use of good will has been addressed.[3]

5. Investment Grade Bond Rating

The proposed rule provides the following definition of investment grade bond rating:

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[3]*See, e.g., Minnegasco, a Division of NorAm Energy Corp. v. Minnesota Public Utilities Commission,* 169 PUR 4th 405 (Minnesota Sup. Ct., June 13, 1996) (good will represents the value of a utility's name and reputation). BHE mistakenly assumed that the *Minnegasco* had been overruled. In that case, the Supreme Court of Minnesota found that the value of a gas utility's good will is not a cost of furnishing utility service, and thus, the commission lacked the statutory authority to impute revenue for the affiliate's use of the utility's good will. S*ee also Black's Law Dictionary,* defining good will as "the benefit or advantage of having established a business and secured its patronage by the public."

> "Investment grade bond rating" is a rating for senior secured debt of above BB+ for Standard and Poor’s, Duff and Phelps Credit Rating Company and Fitch Investors Service and above Ba1 for Moody's Investor Service. If a utility is not publicly rated, investment grade bond ratings may be determined by a private letter rating.

This definition related to certain limitations on utility investment in affiliates.

The provisional rule's definition of investment grade bond rating is revised to require a rating above the specified limit for only one of the major rating agencies.

CMP commented that the proposed rule's requirement that a utility meet threshold credit ratings specified for senior secured debt for each of the major rating agencies was "unduly restrictive." It suggested that a rating above the specified limit by any one of the major rating agencies is sufficient. We agree that an adequate rating by one major rating agency provides sufficient assurance of the utility's financial integrity and consequently of ratepayer protection.

C. <u>Section 3: Separate Corporate Entity for Non-Core Services</u>

Subsection 2(A) of the proposed rule (subsection 3(A) of the provisional rule) prohibited a utility from offering both core and non-core services without establishing a separate subsidiary pursuant to the reorganization requirements in 35-A M.R.S.A. § 708. The proposed rule also allowed a utility to use an existing affiliate to meet the separate corporate entity requirements. These provisions are carried forward from the proposed rule, and the *Cochrane* case, into the provisional rule.

In *Cochrane*, we determined that the most effective way to insulate utility ratepayers from any financial risks of the non-core venture is to require utilities to conduct non-core ventures in a separate subsidiary. We found that:

> requiring utilities to conduct non-core utility activities in a separate subsidiary will best protect utility customers from risks associated with non-core activities. Separate books and records will allow both the utility and the Commission to more easily track expenses and income associated with the non-core venture. Ratepayers may also achieve a degree of insulation from liabilities incurred by the non-core subsidiary. Finally, a separate subsidiary may reduce any potential negative impact on the utility's cost of

> capital resulting from poor financial performance of the non-core activities.

Cochrane Order at 9. We determined that allowing a utility to operate various non-core activities within one subsidiary would reduce the transaction costs of establishing separate subsidiaries.

This section also requires the utility to comply with the requirements of section 707 of Title 35-A and with the requirements of section 4 of the proposed rule (governing value of utility goods, services, and intangibles). No comments were received on section 2 of the proposed rule (now section 3 of the provisional rule). The only modification to this section is that subsections 2(D) and 2(E) of the proposed rule have been consolidated into section 3(D) of the provisional rule. This section provides that "[a] utility must seek Commission approval for all transactions between the utility and its affiliate or affiliates pursuant to 35-A M.R.S.A. § 707 and section 4 of this rule.

D. Section 4: Value of Utility Goods, Services and Intangibles

1. Valuing Utility Equipment, Facilities, Services or Personnel Used by an Affiliate or for *De Minimus* Service

Subsection 3(A) of the proposed rule provided that

> Any utility equipment, facilities, service or personnel used by an affiliate shall be charged to the affiliate at fully distributed costs and recorded as income on the books of the utility.

The proposed rule further required that fully distributed cost allocation (FDC) should be done in accordance with the principles set forth in the FCC's rules regarding cost allocations to regulated and non-regulated activities. In the provisional rule (now subsection 4(A)), we reach a different conclusion:

> Valuing Utility Equipment, Facilities, Services, or Personnel used by an Affiliate or for *De Minimus* Service. Any utility equipment, facility, service or personnel used by an affiliate or used by a utility to provide *de minimus* service shall be charged to the affiliate at the tariffed rate, if available, or in the absence of a tariffed rate at the market price, if available, or otherwise at fully distributed cost. The amount charged in accordance with this subsection shall be recorded as income on the books of the utility.
>
> 1) Fully Distributed Cost Methodology. To the extent a utility must assign and apportion costs between its core utility service and non-core utilities using the fully distributed cost methodology, it shall do so in accordance with the principles set forth in the Federal Communication Commission's rules regarding cost allocations to be regulated and non regulated activities, 47 C.F.R. § 64.901(b)(1-4), attached hereto as appendix A.[4]

EEI disagreed with the proposed rule’s pricing provisions. EEI commented that the pricing provisions for transactions between the utility and its affiliates were asymmetric and that would result in economic inefficiencies. Further, EEI suggested that “pure economic efficiency requires the transfer of good and services from the utility to the affiliate at incremental costs.”

EEI also suggested that “the best way to ensure the transaction [between the utility and its affiliate] takes place is to encourage a negotiated price between net book value and market price,” and that:

> The sharing of assets, services and other resources by the utility and its affiliate at prices between incremental costs and the lower of market prices or fully distributed cost rather than the higher of market prices or fully distributed costs is sufficient to protect ratepayers from cross-subsidization.

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[4]The provisional rule provides that the utility's use of its resources to provide *de minimus* service is subject to the valuation requirements of subsection 4(A). The purpose of including *de minimus* service in this subsection is to require the separate accounting necessary to give effect to the requirement for below the line ratemaking treatment for *de minimus* services. *See* discussion below of subsection 6(A).

EEI also asserted that:

> The price set for asset sharing would also tend to favor incremental costs for goods that the affiliate could procure in competitive markets . . . To impose fully distributed pricing rule will mean the transaction will not take place . . . [and] . . .
>
> To preserve for ratepayers the opportunity to share in the economies . . . . the utility should be allowed to negotiate transfer prices between the market price and [FDC] regardless of which is higher, otherwise the exchange will not take place.

CMP noted that it "does not contest the proposed use of the fully distributed costing methodology" but "that it does more to protect ratepayers than is economically justifiable."

BHE stated that it "supports the utilization of a fully distributed costing methodology to assign and apportion costs" except "[t]he application of [Section 64.901(b)(4)] related to the allocation of central office equipment and outside plant investment . . . ." BHE noted that "[t]his section requires the filing of an 'investment usage forecast,' which currently is not required under MPUC rules and, we believe, would needlessly require utilities to incur substantial costs associated with developing a usage forecast." BHE suggested that central office equipment and outside plant investment be allocated using a general allocator as described in 47 C.F.R. § 64.901(b)(3)(iii).

AT&T discussed modifications that the FCC has made to its affiliate transaction rules in FCC Docket No. 96-150 dated December 24, 1996. Specifically AT&T discussed the FCC's consideration of the "prevailing price method."

The Public Advocate supported the use of FDC as set forth in the proposed rule. He noted, however, that the notice of rulemaking used the terminology "fully allocated" and "fully distributed" and questioned whether the terms were synonymous or whether the Commission was drawing a distinction between the two methodologies.[5]

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[5]In this Order and provisional rule, we have attempted to consistently use the term "fully distributed" rather than "fully allocated." In our Notice of Rulemaking, we did not intend to imply that we considered these terms to connote different methodologies.

MPS's and Dirigo's comments stated that the market value is the appropriate value to be used in all transactions between the utility and its affiliates.

The Commission provided an opportunity for interested persons to comment on whether market value should be used whenever possible. In response, BHE stated:

> Yes. The only situation in which market price, when available, should not govern are 1) when the incremental cost for the utility to provide a service to the affiliate is above market price and 2) when the incremental cost for the affiliate to provide the service to the utility is above market price. In those instances, no transaction should occur and the purchasing company should select an unaffiliated vendor.

CMP responded similarly. It noted that "the only circumstance where the market pricing for affiliated service would not be appropriate is when the incremental costs of providing service exceeds market price." CMP suggested that in situations in which the incremental cost to the utility of providing the service exceeds the market price, "it may be appropriate to add some mark-up (based on market-demand, not Fully Distributed Costs) on top of incremental costs, in order to ensure that the utility covers its total costs."

We agree with EEI that asymmetric pricing provisions for transactions between the utility and its affiliates could result in economic inefficiencies. We disagree, however, with EEI's assertion that "the best way to ensure that the transaction takes place is to encourage a negotiated price between net book value and market that protects ratepayers and maintains the affiliate's competitiveness in non-core markets." We find this argument flawed in two respects. First, our role is not to encourage or discourage transactions between the utility and affiliate. Our proper role is to ensure that such transactions occur in a way that is equitable and that does not impose a burden on core ratepayers. Second, where the market price is higher than the net book value, we question why the utility and its ratepayers should accept a price that is below the value it could obtain from the market. It is not clear why we would permit transactions between the utility and its affiliate in which the utility sells an asset for less than it could get by selling to an unaffiliated entity at the market price. Accounting for transactions at the market value provides the utility and its ratepayers with no less value than would have been provided by a transaction with a non-affiliated entity. Similarly, accounting for transactions at the market value assesses no more cost against the affiliate than a transaction with a non-affiliated entity.

We conclude the market price is the correct price to use for all transactions between utilities and their affiliates. Therefore, our provisional rule requires that all transactions between a utility and its affiliates shall be accounted for at the market value if available.[6] If, and only if, the market value cannot be determined must the utility use FDC as a proxy for the market value.

While we have limited the application of FDC, we do not agree with CMP's comments that FDC necessarily builds in a margin of error in favor of ratepayers. The FCC's FDC methodology allocates the utility's expenses and book values between the utility and its affiliates based on a progression of steps that attempts first to assign as many shared resources as directly as possible and concludes with a general allocation factor for costs that can neither be directly nor indirectly assigned. There are instances when this process will result in an allocation of costs to the affiliate for a particular resource that is higher than the market value of that resource. However, there are also instances when FDC methodology could result in an allocation to an affiliate for a particular resource that is lower than the market value for that resource. Therefore, it is not clear that the FDC methodology necessarily favors utility ratepayers. We thus adopt FDC for utility resources used by an affiliate as a proxy for the market value when the market value cannot be practically determined, not as a hedge in favor of utility ratepayers.

We disagree with EEI's comments that the use of FDC will mean the transaction will not occur. First, as described above, it is not clear to us that using FDC to allocate costs to the affiliate for use of utility resources will necessarily result in a value higher than the market value. Therefore, it is not clear that using FDC would limit the transactions between affiliates and utilities. Secondly, the FCC’s long-standing requirement that telephone utilities use FDC does not appear to have eliminated or even curtailed utilities’ participation in non-core ventures. Therefore, we find no basis for EEI's concern that using FDC, especially in the limited circumstances described by the provisional rule, necessarily means that transactions between utilities and their affiliates will be discouraged.

We disagree with BHE regarding the complexity of the requirement of 47 C.F.R. § 64.901(b)(4). We believe BHE has overstated the complexity of the analysis intended by this

[6]To the extent a tariffed rate exists for a particular resources, that will define the market value.

section. The "investment usage forecast" discussed in 47 C.F.R. § 64.901(b)(4) could be as simple as a utility estimation of the usage its affiliate is expected to make of the utility's resources for the next three years. We assume the utility, for its own planning purposes, would likely already have such an estimation. No other commenter identified this requirement as a problem. Because we believe the allocation process described in 47 C.F.R. § 64.901(b)(4) is more appropriate for these types of resources than the general allocator described in 64.901(b)(3)(iii) and because we believe this aspect of the FCC's rules is not as burdensome as BHE suggests, we do not adopt BHE's recommendation on this issue.

AT&T requested that the Commission's rules reflect the FCC's modifications. Because the provisional rule requires that when utilities use FDC, they do so in accordance with the FCC’s current rules, we believe the provisional rule accommodates AT&T’s concern.

In addition, we conclude that these provisions are consistent with the requirements of 35-A M.R.S.A. § 715 requiring the Commission to adopt rules that prescribe the allocation of costs for resources shared between the regulated and unregulated activities of the utility.

2. Valuing Assets Transferred by Utility to Affiliate

The proposed rule required that assets transferred from a utility to its affiliate would be recorded at the greater of net book value or market price and that assets transferred from the affiliate to the utility would be recorded at the lower of net book value or market price. This approach was included in the proposed rule in part as compensation for what might not be true "arms length" negotiations between the utility and its affiliates.

Our provisional rule provides that assets transferred from the utility to the affiliate and from the affiliate to the utility shall be accounted for at the market value. To the extent it is impossible or impractical to determine the market value, the utility shall propose some other methodology and an explanation of why it is impossible or impractical to determine the market value.

MPS’s and Dirigo’s comments stated that the market value is the appropriate value to be used in all transactions between the utility and its affiliates. EEI suggested that a negotiated price between net book value and the market price is the value that should be used when assets are transferred between the utility and its affiliate. We reject EEI’s proposal to use a negotiated price between net book value and the market price. *See* discussion above of subsection 4(A).

In its initial comments, BHE noted that:

> [t]he recording of assets at market value on the affiliates books creates accounting questions on the books of the affiliate . . . . Moreover, the associated need to the determination [sic] of market value of nonregulated assets transferred to an affiliate would be costly, as it would be difficult to determine the market value of transferred assets. A cost based approach is more reliable and preferred.

BHE appeared to change its position that a cost-based approach is the best value to use for transactions between the utility and its affiliate. In its response to the Examiner's question, BHE appeared to support using the market value for such transactions. *See* discussion above of subsection 4(A).

We are not persuaded by BHE's initial argument that it may be difficult to determine the market value. If it is impossible or impractical to arrive at a reasonable estimate of the market value in a particular instance, another basis for the transfer may be used. In most cases it will be possible to estimate the market value of a tangible asset. Significant disagreements regarding the market value of an asset would more likely occur when the dollars at issue are large, and in those cases it would likely be worth the expense incurred to arrive at a reasonable estimate of the market value.

Further, we do not agree with BHE that recording the assets at market value on the affiliate's books creates accounting difficulties. BHE, and other utilities, prepare financial statements based on Generally Accepted Accounting Practices (GAAP) that do not include transactions between the utility and its affiliates. However, for regulatory accounting purposes, BHE and other electric utilities follow the provisions contained in FERC's uniform system of accounts, as required by the Commission. There are already numerous differences between GAAP accounting requirements and the requirements for regulatory accounting. Therefore, this rule should not create significant accounting difficulties.

We agree with BHE's statement that if the market value is less than the utility's incremental cost, no transaction should occur. *See* discussion above of subsection 4(A). This position is more credible than CMP's assertion that in such circumstances the transaction should occur at a negotiated price between the market price and the incremental price. If the market value is less than the utility's incremental cost, it would be irrational for the affiliate to purchase the asset or service from the utility even at the incremental cost (let alone the incremental cost plus some mark up) when it could have purchased the asset or service from the market at a lower cost. Similarly, if the utility's incremental cost is higher than the market price, the utility should not sell at the market price because it would lose money to do so. In this instance, BHE is correct: no transaction should occur.

On balance, we find the market value is the correct basis for transferring assets between the utility and affiliate. We have chosen to use it in our rules.

3. Sections 4(C) and 4(D): Valuation of Intangibles

L.D. 502 requires that the Commission determine the value of intangibles such as "good will" or “company name." Clearly such intangibles have no book value; however, as the Legislature recognized, name recognition and customer relationships from an established business may be of value to a fledgling enterprise. The proposed rule provided that the value of any utility intangible transferred from a utility to an affiliate or used by the affiliate is the market value of the intangible determined by the Commission in the course of considering the agreement or arrangement involving the use of that intangible. *See* 35-A M.R.S.A. § 707(3)(G). We proposed using an appraisal or market study to aid us in determining the value of the intangible. In section 6, the proposed rule further required the utility to file such an appraisal or market study as part of its petition pursuant to 33-A M.R.S.A. § 707 for approval of an affiliated transaction involving the use of an intangible. The proposed rule contained an alternate methodology for determining the value of good will. This second alternative provided for a rebuttable presumption that a royalty of two percent of the total capitalization of the utility's non-core activity will be imputed for ratemaking purposes. We requested further comment on whether there are other appropriate methods of determining the value of intangibles such as good will or use of company name and customer relationships.

The provisional rule adopts a modification of the second alternative for determining the value of the use of utility intangibles. The provisional rule provides for good will:

> The value of the utility's good will used by an affiliate shall be presumed to be, and calculated as, 1% of the total capitalization of the affiliate, or 2% of the gross revenues of the affiliate, whichever is less, and shall be paid annually by the affiliate.

> Where the name of the utility has been used in Maine by the utility for less than 3 years, the value of good will shall be presumed to be zero. Any party may present evidence that the value of good will is greater than, or less than, the presumptions stated herein.

The provisional rule provides a separate method for determining intangibles other than good will. It provides that

> The value of any utility intangible, other than good will, transferred to or used by an affiliate is the market value of the intangible.

The Public Advocate supported the second alternative of the proposed rule but requested that the final rule clarify whether the payment was an annual payment or a one-time payment. The Public Advocate suggested that the royalty should be an annual rather than a one-time payment because "the affiliate's use of the utility's good will is a continuing year-to-year benefit." The Public Advocate also suggested that the royalty should increase if the capitalization of the affiliate increases.

MPS suggested that Alternative Two, the two percent royalty rebuttable presumption, should apply only to the utility's capital investment in the affiliate rather than the full capital investment. MPS also suggested that the payment should be a one-time payment rather than an annual payment. It further suggested that the rule should distinguish between intangibles that are already allocated under current regulation, such as distribution rights of way, and those that are not. Finally, MPS suggested that the two percent royalty should be applied only to that portion of the utility's capital investment that represents the affiliate's activities in the utility's service territory. MPS reasoned that

> [w]hatever good will an affiliate may enjoy because its relationship with MPS in MPS's own service territory, that good will is likely to disappear once the affiliate begins to operate outside of our service territory. Therefore, if only 25% percent of the affiliate's activity takes place in the utility's service territory, only 25% of its capitalization should be used to calculate the 2% payment.

CMP urged that section 3(C) of the proposed rule should be eliminated. It stated that because the fully distributed costing methodology requirement set forth in subsection 3(A) (subsection 4(A) of the provisional rule) of the proposed rule exceeds the requirements of L.D. 502, no further imputation is required. CMP further stated that "[i]f the

Commission believes itself precluded by statute from eliminating Section 3(C), it should make clear its intent to construe that section narrowly to minimize its uneconomic conveyances." CMP also suggested that if the Commission adopts one of the alternatives in section 3(C), the provision should exclude payments for use of company name or good will if the utility's affiliate is also a utility. CMP argued that costs "imputed" to the utility affiliate under this section would become a cost of service for ratemaking which would drive up rates for the affiliate ratepayers. Dr. Gordon opined, on behalf of CMP, that royalties for the use of company name and good will were arbitrarily determined and that from an economic efficiency point of view, when the use of an established name in some other activity does not impose any additional costs, the price for that use should be zero.

BHE objected to both alternatives. With respect to the first, BHE questioned the utility of lengthy litigation to establish the value of intangibles when the affiliate might be a very small, low-capital venture. BHE cited its Caretaker operation, capitalized at $500,000, as an example. BHE further observed that the proposed rule provided no opportunity to alter the calculation of the value of good will or use of company name to account for changes in circumstances.

With respect to the second alternative, BHE stated that the "blanket prescribed rate of 2% of capitalization fails to take into account the varied arrangements under which a utilities' [sic] good will may be offered and used by a non-core business venture." BHE also asserted that

> in some instances a utility's goodwill may be a reason why a third-party would choose to partner with the utility. This partnership could prove beneficial to both the utility and its ratepayers, but those benefits may not be easily quantifiable at the early stages of the venture and, beyond the entities willingness to partner with the utility it might not be willing to pay for goodwill.

BHE argued that in its current petition for reorganization and affiliated interest approvals related to the creation of and its proposed investment in Bangor Gas Company, the two percent of capitalization royalty could amount to $1 million. Such an imposition would be prohibitive for a start-up venture. BHE suggested that the Commission should accept the payment arrived at between the utility and its co-venturers as the value of good will transferred to or used by the affiliate. If the Commission does adopt a royalty payment, BHE suggested a payment one-half of one percent of net revenues of the non-core venture on an annual basis. BHE noted that this is the same percentage currently used to determine an electric utility's contribution to low-income programs. BHE stated that "by basing the payment on annual revenues as a business venture becomes more successful ratepayers have the ability to receive more dollars over time." BHE also suggested that any royalty paid by a regulated utility should end after five years. At the hearing, BHE expressed concern that it might be difficult to rebut the rebuttable presumption and that as a result an affiliate would not use the name because the price was too high. BHE also questioned whether there would be a separate two percent royalty required for payment of every intangible related to good will (company name, reputation, customer relationships, etc).

EEI disagreed that an affiliate should pay the utility anything for the use of its name or good will. EEI stated that the "disincentives created by the Commission's proposal to require a royalty for affiliate use of its parent's intangibles, such as company name, creates a barrier to the creation of affiliates that, if high enough, could foreclose further opportunities to reduce costs through sharing of utility equipment, facilities and personnel." EEI further stated that given the other ratepayer protections in the proposed rule, the two percent of affiliate capitalization royalty fee is not required to protect ratepayers. EEI suggested that if the purpose of the royalty is to compensate ratepayers for any inadvertent or deliberate cost misallocation that result in subsidies from the utility to the affiliate, the royalty would amount to an impermissible penalty in advance for either intentional or unintentional misallocations that may never occur.

BA-ME disagreed with the second alternative in the proposed rule. BA-ME stated the rule fails to distinguish between intangibles that include costs borne by ratepayers and those that do not. BA-ME identified name and good will as "costless" intangibles. Ratepayers should not receive any payment for such "costless" intangibles according to BA-ME. BA-ME also asserted the rule fails to recognize that the value of a shared intangible asset in any given circumstance is relative to the marketplace. BA-ME asserted that the value of the utility name may be minimal compared to the name recognition value of other players in an unregulated market. BA-ME stated that any consideration by the Commission of the value of an intangible must consider the size, scope and competitiveness of the intended market. BA-ME also stated that if the royalty is intended to compensate ratepayers for a share in the positive value of a utility's intangibles, ratepayers should bear the risk of a loss of such value. BA-ME also questioned how the rule would apply in BA-ME's particular circumstances. It was concerned that the proposed rule might be construed as requiring a royalty to Maine ratepayers for the use of the name "Bell Atlantic" in the provision of telephone services in the other jurisdictions in the

Bell Atlantic region and further noted that the combined effect of a royalty equal to 2% of the capitalization of BA-ME's affiliates that provide interLATA toll, cellular and electronic publishing services "would dwarf BA-ME's entire cost of service." BA-ME suggested that the Commission should determine the value of intangibles through the use of FDC methodology.

We have adopted a variation of the second alternative in our provisional rule. The provisional rule requires that, for intangibles other than good will, the market price should be used. We expect that, in most cases, identifying a market value for intangibles (other than good will) will be relatively straightforward. We are, in any case, satisfied that the benefit to ratepayers, and the benefits to Maine's economy, of establishing the market value of intangibles when they are used by an affiliate exceeds the administrative burden of establishing that value.

For establishing the value of good will, we have adopted a modified form of the second alternative described in the proposed rule. First, in the definition of good will, we have articulated what we believe to be the prime indicia of when the good will of the utility is being used by the affiliate. Thus, whenever the name of the utility is used, or when the affiliate clearly seeks to benefit in selling its services by associating itself with the utility, the rule establishes a conclusive presumption that the affiliate is using that good will.

The market value of the good will transferred, however, may be extremely difficult to determine. We have, therefore, established the price that must be paid for its use: 1% of total affiliate capitalization or 2% of the affiliate's gross revenues, whichever is less, paid annually. A utility, or any other party, may seek to establish a different value. We have reduced the percentage amounts from those in the proposed rule because we have more clearly limited the intangibles subject to this calculation to good will; all other intangibles must be separately valued and accounted for. Moreover, we have made clear that the payment is annual.

We have also established a presumption that the name of any utility in use for less than 3 years in Maine has zero value as good will. The purpose of the rule is to ensure that Maine ratepayers obtain the benefit of value they have helped create. Where a utility name has been in use for as little as 3 years, it is unlikely that the value of the name derives from any utility activities in Maine.

We disagree with MPS that the calculation should be based on the <u>utility's</u> capitalization of its affiliate. The focus of our determination of value is the worth of the intangible to the affiliate. Thus in arriving at a percentage we should focus on the total capitalization of the affiliate -- which is an appropriate indicator of the value shareowners expect to receive from the affiliate -- rather than just the utility's contribution.[7]

We also disagree with CMP and EEI that using FDC for services, facilities and equipment satisfies the valuation of intangibles requirement of L.D 502. In CMP's view, the use of FDC methodology "overcompensates" ratepayers for the affiliate’s use of utility facilities, equipment and services. This alleged overcompensation, according to CMP, is enough to compensate ratepayers for affiliate’s use of utility intangibles. We cannot draw any connection between the use of FDC methodology for the affiliate's use of services, facilities and equipment and the value of intangibles. Moreover, we have limited the application of FDC to those instances when a market price is not available. In any case, we have no basis to conclude that using FDC provides adequate compensation to ratepayers for the use of utility intangibles.

We further disagree with CMP's argument that L.D. 502 should not apply when the affiliate using the utility's name is also a utility. We note that section 707(3)(G) (section one of L.D. 502) makes no such distinction. Moreover, we do not agree that in CMP's example of an electric utility with a gas affiliate, that electric ratepayers should subsidize gas ratepayers by donating the value of the use of the electric utility intangible to the gas affiliate. If, for example, the gas utility were to use the electric utility's right of way, electric ratepayers should receive fair compensation for the use of that utility asset, just as they would if the electric utility were to lease the right of way to a non-affiliate. Contrary to CMP's view that the royalty would "drive-up the cost of gas service for the benefit of electric ratepayers," we believe that an affiliate that provides gas service should expect to pay fair value for an intangible needed to provide that service. The affiliate's ratepayers should also expect to pay the cost of providing that service.

We agree with BHE's concern that there may be situations where it is simply not feasible or reasonable to perform a market study to determine the value of intangibles such as good will. For this reason we have adopted the new provisions concerning good will described above.

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[7]Using only the utility's investment also invites gaming by, for example, using a holding company to funnel investment.

In response to BHE's question and the Public Advocate’s suggestion relating to changes in capitalization to reflect changes in value, the provisional rule allows the utility or any other party to seek to reopen the affiliated transaction proceeding based on a change in circumstances. In addition, if the operating agreement between the co-venturers provided that after a period of time, the utility name would no longer be used, a limitation on the duration of the royalty could be determined at the time of the approval of the transaction.

We do not agree with BHE and BA-ME that the presumption of a percentage of the affiliate's capitalization fails to take into account the varied arrangements under which good will may be offered and used by a non-core business venture. The utility can demonstrate that in some circumstances the use of good will may be minimal or that the company name has limited value given the activities of the affiliate. Similarly any other party may establish that the use of the company name is so extensive or is of such importance to the marketing of the affiliate's product that two percent of capitalization understates the value of the intangible. In addition, the rule limits the one percent of capitalization royalty so that it does not exceed two percent of the gross revenues of the affiliate. This limit addresses concerns about the effect of the royalty requirement on a start-up venture. BA-ME's concerns that Bell Atlantic's name was of little or no value to an affiliate providing service in Maine, because Bell Atlantic does not have an established name and reputation in Maine or because Maine ratepayers did not contribute to the value of the Bell Atlantic name, are fully addressed by our conclusion that a name in use for less than 3 years has a zero value.

We do not agree with BHE that we should simply accept the payment arrived at between the utility and its co-venturers as the value of the intangible. The transactions are not "arms-length" transactions because the utility's shareholders will reap a greater benefit from the affiliate's use of the intangible if the cost of using the intangible is lower.

Finally, we have not reduced the percentage used in the calculation to one-half of one percent of the revenues of the non-core venture as suggested by BHE. This amount is far below the amount determined in other jurisdictions. *See Southwestern Bell Telephone Co.,* 137 PUR 4th 63 (Okl. Corp. Comm. 1992) (provided for a royalty of 5% on gross sales of affiliates to pay for affiliates' use of utility's name, reputation and image); *Southern New England Tel. Co.,* 124 PUR 4th 1991 (Conn. DPUC 1991) (provided for a royalty of 4% of revenues of unregulated subsidiaries' revenues to pay for the use of the SNET acronym by affiliates); *Rochester Telephone,* 145 PUR 4th 419

(NYPSC 1993) (Provided for a royalty of 2% on utility's total capitalization of unregulated operations to pay for use by affiliates of utility name and reputation and also to avoid ratepayer subsidization of competitive enterprise); *Re National Fuel Gas Distribution Corp.* 164 PUR 4th 4 (NYPSC 1995) (provided for royalty of 1% on utility investment in competitive enterprises to avoid ratepayer subsidization of competitive enterprise; no component in royalty for transfer intangible asset such as company name or reputation because utility had made showing that no such transfer would occur).

Because any party may show why a different value should be placed on the use of good will, we disagree with BHE and EEI's argument that the rule will result in the affiliate not using the name. Moreover, the cap of the royalty at no more than two percent of gross revenues addresses concerns about placing an undue burden on a fledging enterprise. We would expect that if there is sufficient value to the use of the name, the affiliate would use it. We also reject the argument that royalty payments should end after five years. We have no reason to conclude that the value would be eliminated over time.

We disagree with EEI's comment that the royalty is based on a theory that either unintentional or intentional misallocations of expenses occur between the utility and its affiliate. The rule is based on L.D. 502 that requires the Commission to determine the value of the use of utility intangibles and requires affiliates to pay the utility for that value. We also reject the argument raised by EEI, BA-ME and Dr. Gordon (for CMP) that there should be no value placed on good will because good will belongs to the shareholders rather than ratepayers. Good will may have no book value; however, as the Legislature recognized, name recognition and customer relationships from an established business can have significant value for a fledgling enterprise. Name recognition and customer relationships exist largely if not entirely because the utility has been allowed to provide service virtually without competition. This history provides ample reason to conclude that the value of the name and customer relationships should redound to the benefit of ratepayers.

Finally, we disagree with BA-ME that good will, in the context of this rule, may have a negative value. If the value of good will as we have defined it is zero, the affiliate will simply choose not to use it. Therefore no payment will be required.

4. <u>Section 4(E): Valuing Use by a Utility of an Affiliate's Equipment, Facilities, Services or Personnel</u>

When the utility uses an affiliate's resources, our proposed rule required that the resource be priced at the same price charged non-affiliates. If no such price is available, the rule proposed to use the lower of FDC or the market value. We continue to support using the price charged to non-affiliates for use of the affiliate's resources, to the extent such a price exists.

We have modified our proposal to require that if there is no price that the affiliate charges non-affiliates for the use of its resources, the affiliate's resource will be priced to the utility at a reasonable estimate of the market value. To the extent it is impractical or impossible to estimate the market value, some other method, such as FDC may be used. The utility will bear the burden, however, of showing why it is impossible or impractical to obtain an estimate of the market value.

No commenter disagreed with our proposal to use the price charged to non-affiliates for the utility's use of the affiliate's resources, to the extent such a price exists. The commenters disagreed, however, on how to deal with the absence of an available price. CMP recommended that if such a price was not available, FDC should be used. EEI commented that the:

> [t]he sharing of assets, services and other resources by the utility and its affiliate at prices between incremental costs and the lower of market prices or fully distributed costs rather than the <u>higher</u> of market prices or fully distributed costs is sufficient to protect ratepayers from cross-subsidization . . . .

MPS and Dirigo supported using the market price for all transactions between the utility and its affiliates.

We have concluded that our proposal to use the lower of the market value or FDC is inappropriate because transactions between a utility and its affiliates should reflect the market price. Moreover, it is not clear to us how FDC would be applied to a utility's non-utility affiliate. The FDC methodology allocates the utility's book costs based on the process described by the FCC. The utility's book costs are based on the utility's expenses, depreciation schedules and rate of return. These are all subject to the Commission's scrutiny and approval. In the case of a non-utility affiliate's resources, however, the Commission has not examined or approved the affiliate's depreciation schedules, expenses or its profit. For these reasons, we are concerned that using FDC for a non-utility affiliates would be impractical (as well as uneconomic) and have required instead that the use by a utility of an affiliate's resources be priced at the market price.

5. Section 4(F) and (G) Cost Manuals; Reports

The provisional rule, consistent with the proposed rule, requires the use of a cost manual or other written material documenting the cost allocation methodology. In addition, the rule requires that the utility charge its affiliate for the value determined under this section and file as part of its annual report the amount received from its affiliates for the use of the utility's facilities, services and intangibles. Finally, the rule prevents the utility, without specific Commission approval, from offering payment terms that are inconsistent with those offered in the course of normal business. We agree with the Public Advocate that nothing in the rule is intended to permit a utility to give overly "friendly" or generous payment terms to their affiliates. Such treatment would represent an inappropriate transfer of wealth from the utility and its ratepayers to the affiliate. Thus, it is expected that the affiliate will actually pay the utility, within reasonable periods of time, for the use of any utility facility, service or intangible. This provision reflects the statutory requirement that

> When any of its facilities, services or intangibles are used by the affiliated interest, the utility's costs must be charged to and received from the affiliated interest based upon [the value determined by the Commission].

35-A M.R.S.A. § 707(3)(G) .

A. Section 5: Limitation on Utility Investment in Affiliates

Section 4 of the proposed rule (section 5 of the provisional rule) contained certain restrictions on utilities' investments in non-core activities. These restrictions included limits on the permissible level of total investment in affiliated interests to a level not to exceed five percent of the utility's total capitalization, and a prohibition on utility investment in an affiliate if the utility's bond rating is below investment grade or if the utility has filed for, or been granted, a temporary rate increase pursuant to 35-A M.R.S.A. § 1322, within six months of the filing for approval to invest in the affiliated interest. We have modified the five percent cap provision as discussed below. In addition, as discussed above, the provisional rule contains a modified definition of investment grade bond rating.

MPS suggested that five percent of capitalization should be the limit for an amount that a utility may invest without Commission inquiry into the riskiness of the venture, but objected to having a maximum investment limitation of five percent of capitalization. Instead, it suggested that a utility should be allowed to invest more than five percent if it could meet the "not adverse to the public interest" standard under section 707 of Title 35-A.

CMP stated that "[a]n investment cap as proposed in Section 4(A) is an appropriate limitation on a utility's investments in its affiliates and promotes the objective of maintaining the financial integrity of the utility." CMP noted that this provision does not apply to a holding company's investment in its non-core subsidiaries. It also suggested that the maximum investment allowed be ten percent rather than five percent. CMP's witness Dr. Kenneth Gordon stated that the five percent limitation on investment by utilities was reasonable and noted that such a limit was imposed in Massachusetts upon Boston Edison. Dr. Gordon stated however that the limit should not be applied to holding company investments.

BHE objected to any cap on the amount the utility can invest in a non-core affiliate. BHE stated that the Commission should examine each request on a case by case basis.

EEI suggested that a cap is unnecessary because the Commission can protect ratepayers by maintaining a separate capital structure for the utility. EEI stated "if an affiliate in an unregulated line of business had higher risks than the regulated entity's risks and these risks caused the cost of capital of the utility to be higher than it otherwise would have been, than the practice of regulation should aim to determine the capital costs associated only with the utility and its operations." Finally EEI stated that if the Commission believes that a cap on investment is necessary, the Commission should adopt a cap much higher than five percent. EEI suggested a standard of the greater of 15% of total capitalization or $50 million dollars.

The Public Advocate supported the proposed rule's five percent of total capitalization ceiling on investments in non-core business ventures. He noted that even when a utility's proposed investment will not exceed the five percent cap, the Commission should "monitor the riskiness of the investment strategy of a utility."

We have modified subsection 4(A) (now subsection 5(A)) in the provisionally adopted rule to allow electric and gas utilities that are in sound financial condition (see discussion below) to invest without specific Commission approval an amount which, when aggregated with its other investments, does not exceed five percent of the utility's capitalization. If approval is required because the investment would cause the utility to exceed the five percent cap, such approval would be granted only if the utility met its burdens under sections 707 and 708 of Title 35-A. Thus, under the provisional rule, we may, in a specific case, limit the amount of aggregate investment, see e.g. 35-A M.R.S.A. § 708(2)(A)(7); however we will determine whether a limitation is justified on a case by case basis.[8]

In making this modification, we do not agree with EEI that simply maintaining a separate capital structure provides adequate ratepayer protection. We believe that ensuring adequate ratepayer protection includes determining whether an investment in the non-core activity will impair the financial integrity of the core business. We agree with CMP that a limitation on investment "promotes the objective of maintaining the financial integrity of the utility." However, we are concerned that in imposing an inflexible limit on investment, we are forced to choose a limit that may be too high or too low, given the particular circumstances of the utility. For example, if we raised the ceiling to ten percent to address concerns about imposing a limit that may be unnecessarily restrictive in some circumstances, we might be permitting investments that may, in some circumstances, impair the financial integrity of the utility. Although the proposed rule's rebuttable presumption provision would partially address this concern, it would shift the burden to the party seeking to show that the investment will harm the utility and its ratepayers. Thus, we believe that a case by case analysis for investments that exceed five percent of the utility's total capitalization is appropriate. For investments of five percent or less by a utility in sound financial condition, a case by case analysis is not necessary. We determine that five percent of capitalization establishes an aggregate investment level that is sufficiently low, given the other protections set forth in this rule and in sections 707 and 708 of Title 35-A, to minimize risks to ratepayers. As stated below, the amount a holding company may invest will be dealt with in cases involving the formation of the holding company and are not addressed in this rule.

In subsection 4(B), the proposed rule provided for a rebuttable presumption that if the utility has attained investment grade bond rating, has not filed for or been granted an emergency rate increase and the amount that it seeks to invest will not cause the utility to exceed the five percent cap, a rebuttable presumption exists that the investment will not harm the utility or its ratepayers. The Public Advocate agreed with this provision. No other party commented specifically on the rebuttable presumption. We have eliminated this provision in the

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[8]This provision does not exempt a utility from the provisions of the rule and section 707 of Title 35-A relating to affiliated transactions.

proposed rule because we have determined as discussed above that there is minimal risk of impairing the integrity of a financially sound utility in allowing an investment of no more than five percent of the utility's capitalization.

Subsection 4(C) of the proposed rule prohibited further investment in non-core activities by a utility that has filed for or been granted an emergency rate increase within six months of the request for approval of investment in a non-core venture. Similarly, the proposed rule prohibited a utility investment in a non-core venture if the utility's bond rating is below investment grade. The provisional rule has maintained these limitations on investment (in subsection 5(B)) although, as discussed above, the provisional rule contains a less restrictive definition of investment grade bond rating.

MPS commented that a utility should not be allowed to take advantage of the presumption extended to investments of five percent or less if it is exhibiting signs of financial weakness, but it disagreed that such conditions should be a bar to investing in a non-core venture. MPS stated that such utilities should have an opportunity to demonstrate to the Commission how investing in the venture might improve the utility's financial condition. MPS agreed that filing for or receiving an emergency rate increase within six months is reliable evidence of financial weakness but did not agree that a bond rating below investment grade necessarily indicated that a utility's financial condition is not sound. MPS argued that while it could probably not attain investment grade bond rating due to its "small size, nuclear exposure and our contract with Wheelabrator-Sherman," these factors have not resulted in lack of access to financing on reasonable terms. MPS argued that a more appropriate standard for determining financial weakness would be if the utility's "financial performance for the most recent quarter places it in default of any of the financial covenants (interest coverage tests, capitalization ratios, etc.) in any of its debt instruments." If a utility failed to meet this standard or had filed for or been granted emergency rate relief within the specified period of time, it would be deprived of the presumption under subsection 4(B).

BHE disagreed with the limitation on investment as proposed in subsection 4(C). BHE argued that its recent request for emergency rates should not be viewed as an indication that its financial condition will continue to be weak. According to BHE its financial health will be restored once the Commission orders into effect permanent rates "designed to provide a reasonable opportunity to earn a fair return on capital." BHE stated:

> [I]f providers of both debt and equity capital are reasonably convinced that Bangor Hydro has been provided such an opportunity, capital will be available to the Company on reasonable terms. Unlike the current situation, if Bangor Hydro cannot reach reasonable accommodations with its existing lenders, we expect that other borrowing alternatives will be available that can provide capital on reasonable terms. Under the same analysis, if potential investors are convinced that Bangor Hydro's plans for investing in affiliated ventures are reasonable and afford the prospect for a fair return, capital should be available for required investments.

BHE also disagreed that bond rating is a reliable indicia of the overall financial health of the rated company. BHE stated that the circumstances surrounding the rating agency's opinion of the overall financial health of a Company may change. At the hearing BHE stated that a utility's past financial performance may be considered by the Commission but should not disqualify a utility from investing in a non-core activity.

CMP did not challenge the limitation on non-core investments when a utility has not attained investment grade bond rating but suggested that requiring a utility to meet the investment grade bond rating for each of the major rating houses is unduly restrictive. CMP suggested that the bond rating limitation apply if a utility does not attain investment grade rating for any of the major rating houses. As discussed above, we have adopted CMP's suggestion.

The Public Advocate supported the prohibition on non-core investments when the utility's bond ratings are below investment grade or when the utility has filed for or been granted emergency rate relief within 6 months. The Public Advocate stated:

> We do not believe that this prohibition should be weakened by changing it to a rebuttable presumption. It is inappropriate for a utility to focus its attention on non-core ventures when its core financial integrity needs the utility's full attention and resources.

We have not modified these provisions of the rule although, as discussed above, the bond rating requirement is less restrictive because we have modified the definition of investment grade bond rating. Thus, under the provisional rule, a utility that is improving financially but which has not attained investment grade bond rating from all rating agencies will not be barred from investing in non-core ventures.

We determine that the bond rating provides an objective criterion for determining the financial health of the utility seeking to invest in a non-core venture. Rating agencies base their opinions on factors such as cash flow and debt service coverage ratios. We believe that it is reasonable to rely on such agencies' expertise in determining the financial health of a utility.

We disagree with BHE that bond ratings are not reliable indicia because a Company's financial circumstances may change. If the company's financial health improves, it can later seek permission to make the non-core investment in accordance with the provisions of the rule. Similarly if a utility's financial condition improves after the Commission has substituted permanent rates for temporary rates, it is unlikely that the utility will be affected by the 6-month bar on investment.[9]

Finally, we disagree with MPS that the bond rating requirement should be eliminated because MPS would have difficulty obtaining an investment grade bond rating. A utility may seek an exemption from any provision of this rule in accordance with section 9 of the provisional rule. Thus, if MPS seeks to make a non-core investment without the requisite bond rating it could seek a waiver from this provision by demonstrating that its financial condition is sound, notwithstanding its lack of an investment grade bond rating. We disagree that the potential benefits of a non-core investment should mitigate concerns about the impact of any investment on a financially troubled utility. We are unwilling to put ratepayers at risk on the basis of possible but uncertain benefits to the utility of a non-core investment.

Finally we determine that these minimum standards for determining financial soundness should not be weakened to a rebuttable presumption. As discussed above, a utility's inability to attain investment grade bond rating provides an

[9]BHE's recent request for a temporary rate increase pursuant to 35-A M.R.S.A. § 1322 provides a good example. It was granted a temporary rate increase on June 25, 1997, Docket No. 97-201. Its request for permanent rate increase was decided on February 9, 1998, Docket No. 97-116. If as a result of the permanent rate increase, the Company's financial condition improves to the degree that it attains investment grade bond rating, the 6-month bar will no longer be in effect and the Company will be permitted to invest up to five percent without specific approval from the Commission.

objective criterion for determining that the utility's financial condition is weak. Similarly, a request for or granting of emergency rates indicates the utility's need for immediate access to cash to maintain the financial integrity of the core venture, a need that is inconsistent with a utility's investment in a non-core venture. Moreover, as discussed above, the bar is not permanent. Rather it provides a period of time for the utility to regain its financial health so as to reduce the risk of harm to the utility and its ratepayers from investment in a non-core venture. We agree with the Public Advocate that it is appropriate for a utility in weak financial condition to focus on the financial integrity of the core business rather than diverting its resources to a non-core venture. If a utility is able to demonstrate that its financial condition is sound -- i.e. that it has attained an investment grade bond rating -- before the end of the 6-month ban, it could request an exemption from this provision.

We conclude that the limitations on investment set forth in 5(B) of the provisional rule provide an objective indication of the utility's financial condition, ensure adequate ratepayer protection, give utilities some guidance when determining whether to incur initial transaction and regulatory costs in pursuing investment in a non-core venture, and are not unduly restrictive.

E. Section 6: Ratemaking Treatment

The proposed rule provided that all non-core utility activities would be treated as below-the-line. This means that the costs and revenues of the non-core activity are excluded from those considered in determining rates for core activities. This provision is consistent with our analysis in *Cochrane* that below-the-line treatment is appropriate because it "allocates the potential risks and rewards of the non-core activities to shareholders alone and holds ratepayers indifferent to the presence of the non-core activity." No commenter disagreed with this provision. We have maintained this provision but have clarified that *de minimus* services also should be accounted for below the line. The provisional rule explicitly provides for such treatment. This clarification is consistent with the policy of the rule that all non-core services shall be accounted for below the line. *De minimus* services are excluded from the definition of non-core services and thus are not subject to the separate corporate entity requirement of the rule. However, ratepayers should be indifferent to the revenue impact of *de minimus* services because such services are not included in the definition of core service. As stated above in the discussion of section 4(A) of the provisional rule, the provisions applicable to valuing the use of utility resources by the affiliate also are applicable to *de minimus* service.

The proposed rule provided a rebuttable presumption that allocated to ratepayers amounts paid by the affiliate for use of a utility intangible. This provision remains unchanged in the provisional rule. The provisional rule, consistent with the proposed rule, also acknowledges that there may be circumstances in which a utility acquires an intangible that is wholly unrelated to the utility's provision of service to ratepayers.

The Public Advocate agreed with allocating the value of intangibles to ratepayers but argued that there was no need for a rebuttable presumption. The Public Advocate stated:

> we are unaware of any utility intangibles that are unrelated to a utility's provision of service to ratepayers. Even if there are examples of such intangibles, it seems apparent that the source of the value of such intangibles stems from operation of the core business and the revenues generated by ratepayers. For these reasons, we see no reason for the rule to create a rebuttable presumption rather than an absolute rule concerning the allocation of the value of intangibles.

MPS and BHE disagreed with the allocation of affiliate payments for good will to ratepayers. MPS suggested that the legislation does not require such an allocation and proposed that payments be allocated 50% to shareholders and 50% to ratepayers. BHE suggested that because "shareholders have shared a disproportionate amount of the expenditures in developing the good will, shareholders should share in benefits derived from the use of Bangor Hydro's good will."

We believe that the ratemaking treatment in the provisional rule is consistent with the intent of L.D. 502. The statute requires that if an affiliate uses a utility facility, service or intangible, "the utility's cost must be <u>charged to and received</u> from the affiliate based on [the] value [determined by the Commission]." (emphasis added) This language indicates the Legislature's intent that such amounts would be included in the utility's revenues for the purpose of ratemaking. We further base our conclusion on the title of L.D. 502, "An Act to Require Fair Compensation for Ratepayer Assets Used by a Subsidiary or Affiliate of a Utility." This language identifies utility intangibles, facilities and services as <u>ratepayer</u> assets.

We also have considered the language of section 713, which states "[t]he Commission shall allocate between a utility's shareholders and ratepayers, costs for facilities, services or intangibles, including good will or use of a brand name, that are shared between regulated and unregulated business activities." 35-A M.R.S.A. § 713. We interpret this language to indicate that costs of certain items shared between the utility and the affiliate are allocated properly and that cost shifting from affiliate to the utility's ratepayers does not occur. Thus, for equipment, facilities, and services the use of the market value (or failing that, FDC methodology) addresses this concern. Similarly, we read the inclusion of good will and company name to require the Commission to determine the amount that the affiliate will compensate the utility and thus its ratepayers for the use of the utility's name and reputation. We disagree with MPS and BHE that L.D. 502 envisions that shareholders receive some of the benefit of items the Legislature has identified. Moreover, in enacting L.D. 502, the Legislature appears to have rejected arguments that good will must be reflected as an item on utility books in order to entitle ratepayers to receive revenues for the use by an affiliate of the intangible asset. Other jurisdictions have rejected similar arguments in imputing a royalty for the use of good will and other intangible benefits. In a case involving Rochester Telephone, the New York Public Service Commission based its royalty provision in part on the rationale that such assets are funded by rates. The New York Commission stated:

> Because ratepayers have funded the salaries, training, advertising, and other activities that generate good will, they are entitled to rate recognition of revenues received by the utility in exchange for the use of that asset by an affiliate or otherwise . . . .
>
> That good will does not appear as a discrete item has no bearing on this jurisdictional issue, for it is none the less a utility asset funded by rates.

Rochester Telephone, 145 PUR 4th at 431. *See also* *Re Southwestern Bell Telephone Company*, 137 PUR 4th at 152-153.

We also conclude that it would be illogical to require the affiliate to pay the utility for the use of a ratepayer asset and then allocate some of that payment back to the shareholders of the utility which are also shareholders in the affiliate. If that were the Legislature's intent, it would be more logical to have required only a partial payment for the use of the ratepayer asset. Finally, if, as MPS suggests, the purpose of the provision is to prevent the affiliate from having an undue advantage by obtaining intangibles (and other assets) at less than fair value, simply allowing the payment to be funneled back to shareholders who can then provide additional capital to the affiliate would appear to have limited effectiveness. We do not reject the possibility that a utility may be able to provide evidence that a different allocation is appropriate. As suggested by BHE's comments, a utility may seek to rebut the presumption set forth in subsection 6(B) by showing that shareholder-paid advertising costs have contributed to the value of the intangible. Different allocations based on such claims will be determined on a case-by-case basis. Finally, we disagree with the Public Advocate that we should make the rebuttable presumption that payments for intangibles should be allocated to ratepayers a conclusive presumption. This provision gives us some flexibility if an asset is wholly unrelated to the utility's provision of service to ratepayers.

The provisional rule adds subsection 6(C). This section provides:

> subject to the allocation requirements set forth in subsection B of this section [presumption in favor of allocating to ratepayers positive value of utility intangibles transferred to or used by an affiliate], the specific ratemaking methodology used to reflect the value of an intangible other than good will will be determined in the proceeding for approval of the affiliated transaction pursuant to 35-A M.R.S.A. § 707.

The purpose of this provision is to indicate that where there is no provision in the rule for an annual payment, the determination of how the value of the intangible will be flowed through to ratepayers, consistent with the presumption in subsection 6(B), will be determined on a case-by-case basis during the course of the proceeding for approval of the affiliated transaction.

F. Section 7: Filing Requirements

Section 6 of the proposed rule (section 7 of the provisional rule) contained filing requirements for notification of the undertaking of each non-core activity and filing requirements for section 707 and 708 filings. Most of the information required is ordinarily part of the utility's case in such filings. This section also required that the company file a market study or appraisal estimating the market value of the intangible. No parties commented on this section. This provision has been modified in the proposed rule to provide that if the intangible is good will, a market study is not required to be filed. The provisional rule also requires that if a utility seeks to contest the presumption set forth in Section 4(C), the utility shall file a market study or other relevant information providing evidence that an alternative value should be considered. These requirements are necessary in order to meet the Commission's obligation under L.D. 502 to determine the value of the intangible within 180 days. Other minor modifications have been made to make the filing requirements consistent with the modifications to methods of valuing utility and affiliate resources and assets. *See* above discussion of section 4.

G. Section 8: Standards of Conduct

This section of the rule sets forth mandatory standards of conduct including the use of customer information. The provisions on customer information are consistent with the treatment of customer information in the *Cochrane* case. The proposed rule imposes additional minimum standards of conduct that are intended to "ensure that the utility or the affiliated interest does not have an undue advantage in any competitive market as a result of its regulated status or its affiliation with a regulated utility." 35-A M.R.S.A. § 713. The proposed rule also envisions that additional conditions may be necessary in specific circumstances to protect the public interest. The rule does not address codes of conduct governing marketing affiliates of transmission and distribution utilities under electric restructuring. 35-A M.R.S.A. § 3205. This matter will be addressed in a separate rulemaking. This section of the rule has not been modified.

BA-ME suggested that the rules governing use of CSI and ACI conflict with rules under consideration by the FCC. BA-ME also commented that Section 7(B) of the proposed rule (now Section 8(B)) is vague and should be deleted. Finally, BA-ME asserted that section 7(C) (now section 8(C)) is duplicative and potentially in conflict with rules under development at the FCC.

We have not modified these provisions. Because LECs are not subject to these provisions of the rule, we are not concerned with possible conflicts with FCC rules. We do not agree that 8(B) of the provisional rule, requiring a utility, upon a request by a non-affiliate, to provide information related to its status as a public utility if the utility has provided such information to its affiliate, should be deleted. We note that no other interested person expressed concern with this provision. Moreover, we consider that this provision is an important aspect of preventing preferential treatment by a utility to its affiliate. *See* 35-A M.R.S.A. § 713.

H. Section 9: Waiver

The proposed rule did not contain a waiver section, however the notice of rulemaking noted that under chapter 110, a waiver could be granted if the Commission finds that there is good cause for the waiver or compliance would be unduly burdensome and it finds that the deviation or waiver will not impair the policies of the chapter from which the deviation or waiver is sought. The provisional rule incorporates in section 9 an explicit waiver provision.

I. Miscellaneous Comments

1. Transactions between Utilities and Utility-Affiliates

The proposed rule, as constructed, governed utilities' relationship with their affiliates. It did not distinguish between non-utility affiliates and utility affiliates. We continue to believe no distinction is necessary and therefore have not modified our provisions to specifically exclude utility-affiliates.

In its supplemental comments, EEI suggested that we should review the California Public Utilities Commission's (CPUC) decisions regarding this issue. EEI also suggested that "this Commission has the opportunity to permit Maine consumers to benefit from the economies of integration that can drive a utility to merge with another utility" and "[t]he Commission, therefore, should not apply the regulations of 'non-core' activities to the clearly 'core' activities of a utility that happens to be an affiliate of another utility."

BHE also suggested the requirements for utility to utility-affiliate transactions should be treated differently. BHE noted that based on the summary of the rule, the proposed rule "could be viewed to not apply" to a utility's investments in and transactions with regulated activities. BHE filed supplemental comments in which it suggested that the investment cap proposed under Section 4(A) of the proposed rule and the limitations on investment included under Section 4(C) (now 5(B) of the provisional rule) of the proposed rule should not apply when a utility invests in a "sound" regulated activity.

BHE further suggested the cost allocation and transaction provisions should be different when applied to utility to utility-affiliate transactions. Specifically, BHE noted that:

> the Commission should not impose rules that result in favoring one set of ratepayers (the investing utility's ratepayers) over the other set of ratepayers (the affiliate utility).
>
> . . . .
>
> [I]f both the investing utility and the affiliate are regulated monopolies, over which the Commission controls the rates charged and may impute revenue from one to the other, it is already to the advantage of both entities to exchange services and facilities at market value.

In response to EEI's comments, we note that the California Commission found that its rules adopting standards of conduct governing relationships between utilities and their affiliates should apply to transactions between a utility and another affiliate utility. The fact that in the context of a merger application the California Commission provided for the possibility of waivers from the rule is not dispositive of the question of whether investments in and transactions with utility affiliates should be excluded from this rule.

We do not disagree with BHE that the Commission should not favor one set of ratepayers over another set. Our provisional rule now provides that all transactions between utilities and their affiliates -- non-utility affiliate and utility-affiliates -- occur at the market value or a proxy for market value. For the same reasons the market price is the right price to use for transactions between a utility and its non-utility affiliate, it is the right price to use for transactions between a utility and its utility-affiliate. By using the market price, or a proxy for the market price, for all transactions between a utility and its affiliates our rules do not favor either the utility or the affiliates and likewise do not favor the investing utility's ratepayers or the affiliate-utility's ratepayers.

We further disagree that the limitation on investment set forth in section 5 of the provisional rule should be inapplicable to a utility’s investment in an affiliated utility. We believe that our responsibility to ensure ratepayer protection in approving a utility investment in an affiliate is not met by simply assuming that there is minimal risk in investing in a public utility affiliate.[10] Ratepayers of a financially troubled utility are not adequately protected by permitting investment in a non-core venture on the basis of possible but uncertain benefits of such an investment to the utility.

B. Preventing Utilities and Affiliates From Having an Undue Advantage in Competitive Markets

Section 713 of Title 35-A provides: "the Commission shall also attempt to ensure that the utility or the affiliated interest does not have an undue advantage in any competitive market as a result of its regulated status or its affiliation with a regulated utility.” Both our proposed rule and our

[10]We are currently confronted with this situation in BHE’s petition for approval of an investment in Bangor Gas Co., Docket No. 97-796. In that case, the Commission will consider the question of whether BHE’s investment in an affiliated gas utility is appropriate given the utility’s current financial condition.

provisional rule provide appropriate protection against predatory pricing.

In its Comments, EEI stated that:

> The Commission, during discussions of the cross-subsidization issue, expressed concern over the potential for predatory pricing by the incumbent utility and its affiliate.

and that:

> The Commission's concern with respect to this issue may arise from a belief that the affiliate would be able to engage in predatory pricing practices as a consequence of the utility distribution company cross-subsidizing its costs through the regulated rates.

EEI argued that: 1) the separation standards and pricing rules in the Commission's proposed rule adequately protect ratepayers from cross subsidization that might allow predatory pricing by the affiliate; and 2) because the markets being entered by the affiliates are competitive, there is little risk predatory pricing would be a successful business strategy.

While we do not view our primary role in this rulemaking to be one of ensuring the affiliate's competitive market is operating correctly, the Legislature has directed us to address the issue of "undue advantage." See 35-A M.R.S.A. § 713. In accordance with these and other provisions of Title 35-A, we have established pricing and standards of conduct provisions that do not give an affiliate an undue competitive advantage. We agree with EEI that our proposed rule fulfilled this obligation. By using the market value or a proxy for the market value for all transactions between the utility and its affiliates, neither the affiliate's nor the utility's position in the competitive market place will be distorted by the fact that they are affiliated.

C. Effect of the Rule Under a Holding Company Structure

Both the proposed rule and the provisional rule apply to utilities[11] and their interactions with affiliates.[12] CMP, OPA

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[11]Except those that have specific exemptions.

[12]As described earlier, the Commission will be initiating a rulemaking pursuant to 35-A M.R.S.A. § 3205, that will more specifically govern the relationships between transmission & distribution utilities and their affiliated competitive providers.

and EEI have provided comments suggesting or questioning the degree to which certain requirements of this rule should apply if a utility is organized under a holding company structure.[13] For example, both CMP and the Public Advocate focused on the applicability of the proposed five percent investment cap if a holding company rather than utility invests in an affiliate. We have not examined this question in this proceeding. We plan to consider the standards applicable to holding company formation and structure in the proceeding to approve CMP's proposed holding company formation and structure, Docket No. 97-930.

D. Prospective Application of the Rule

We envision that this rule will apply to existing non-core activities. Thus, if a utility is providing a non-core service, it will be obligated under the rule to transfer that service or activity to an affiliated entity. We do not envision that this rule will apply to existing affiliated transactions that have already been approved by the Commission.

TAM commented that any rule applicable to telephone utilities be made prospective in its application. The Public Advocate commented that there should be a rebuttable presumption that existing affiliated transactions are exempted from the rule, but that parties have the opportunity to request that the Commission review any aspect of an existing transaction that may not be in compliance with 35-A M.R.S.A. § 713. We intend to apply the rule prospectively.

Accordingly, we

O R D E R

1. That the attached Chapter 820, Utility Requirements for Non-Core Activities and Transactions between Affiliates, is hereby provisionally adopted;

2. That the Administrative Director shall submit the provisionally adopted rule and related materials to the Legislature for review and authorization for final adoption;

[13] BA-ME has also commented on the certain issues with respect to a holding company structure, in particular with respect to good will. Their comments are discussed in the good will section of this Order.

3. That the Administrative Director shall file the provisionally adopted rule and related materials with the Secretary of State; and

4. That the Administrative Director shall send copies of this Order and attached rule to:

a. All electric, gas and water utilities and all local exchange carriers in the State;

b. All persons who have filed with the Commission within the past year a written request for notices of rulemakings;

c. All persons on the Commission's list of persons who wish to receive notice of all electric restructuring proceedings;

d. All persons who have filed comments in Docket No. 97-886; and

e. The Executive Director of the Legislative Council (20 copies).

Dated at Augusta, Maine this 18th day of February, 1998.

BY ORDER OF THE COMMISSION

____

Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR: Welch
Nugent
Hunt